Nomad Foods Limited

Third Quarter Earnings Call

November 29, 2016

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PRESENTATION

Operator:

Good day everyone and welcome to the Nomad Foods Third Quarter Earnings Call. Today's conference is being recorded. At this time I'd like to turn the conference over to Mr. Paul Kenyon, CFO. Please go ahead, sir.

Paul Kenyon:

Good morning, good afternoon everyone. Before we start I would draw your attention to the disclaimer on Slide 2. I do not propose to read through it but ask that you do so in your own time. With that, I will hand you over to Stéfan.

Stéfan Descheemaeker:

Thank you and good morning, good afternoon everyone and thank you for joining us on our Third Quarter 2016 Results call. As you just heard, I'm joined today by Paul Kenyon, our CFO. I will start by saying that we continue to see some positive results of our strategy and its execution. Our focus remains on Must Win Battles and disciplined integration of Findus, and it's paying off.

As I said at the second quarter results call, we have clear priorities in 2016: firstly, stabilizing sales by progressively slowing the rate of decline at the top line through the balance of the year; secondly, delivering on our synergy commitments from the Findus deal; and thirdly, pursuing consolidation of the European Frozen category.

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Taking each of these points in turn, firstly I was really pleased to see a further slowing of the rate of decline in sales in the third quarter. The rate of improvement is lower than what we have seen in recent quarters but it's important to remember that the autumn cabinet reset only happens at the end of the quarter, from mid-September and onwards, and so the impact of the new product launches is largely limited to the selling to the trades. Our expectations remain that we will see a slowing of the rate of decline in the fourth quarter, although we have some headwinds in the business. That means that the rate of improvement will be smaller than the third quarter. Paul will give you a more detailed perspective on this in his comments.

The autumn cabinet reset saw the first major wave of Must Win Battle activation in terms of product launches and the following products are now on the shelves. In the UK we launched a new premium fish finger under the Inspirations range; a new gluten-free variant in our standard Fish Finger range and the relaunched our Coated Fish products with a new improved crumb.

In Italy we relaunched our existing Natural Fish range with new hake products alongside the introduction of new tuna and salmon products within this category. Our Battered Fish range was also relaunched and now includes kipling (phon), a product copied from our Netherlands business.

In Norway we expanded the Coated Fish range with the introduction of a new fish and crisp variant which was launched in the quarter.

I have mentioned before that one of our key learnings from the Must Win Battles launches so far has been the importance of 360 degree activation. That is to say we need to have new products news, high quality packaging, effective advertising copy and strong promotion mechanics all in market at the same time. Our teams are highly focused on delivering this 360 degree activation once the target levels of distributions have been achieved for the new products.

This is a critical point as markets vary widely in terms of distribution efficiency. For example, in the UK where the grocery challenge is highly concentrated, reaching good levels of distribution can be achieved within two to three to four weeks, with target distribution taking two to three months.

In Italy where the grocery market is still extremely fragmented, reaching the target distribution levels can take up to six months.

Despite the need to time advertising to follow the (inaudible), a number of Must Win Battles in September. For example, in our Fish Fingers battle we went back with the iconic Caption in the UK, Germany, Belgium and the Netherlands towards the end of the quarter, and early indications are positive with Fish Fingers showing an increase of 4% for the Group.

Another Must Win Battle is Natural Fish. We are also seeing the positive growth. In France, we grew by 8.3% versus quarter three last year, driven by more effective promotion activity and innovative product launches.

In our Italian markets, we activated Peas and Fish Fingers and towards the end of the quarter Natural Fish Soffacini and Gratinati. All the early indications are encouraging, as I mentioned earlier, achieving full distribution of the growth associated with this can take up to six months in Italy, but we are optimistic that we have the right mechanics in place now to achieve this.

Moving on to margin performance, Adjusted EBITDA margins was 2% higher year-on-year, although I would caution that it was impacted by the release of the year-to-date accruals related to groups annual bonus scheme which we not pay out this year. Cash conversion remains strong and by the end of the third quarter we have delivered €160 million of our €200 million pre-restructuring and non-recurring cash flow commitment, so we are well on track.

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Turning to our second priority, the integration of Findus continues to be a key focus and we have delivered approximately €10 million in run rate synergies so far and our integration process remains on track. This equates to around €2,5 million in the third quarter, and just over €5,5 million year-to-date. This apparently flattening out of the rate of synergy delivery was expected and is due to the synergies in our French business as the old Iglo portfolio has been beefed up by certain retailers ahead of ordering the replacement Findus branded product. Paul will cover this in more detail in his comments.

Lastly, as a reminder, our overall target remains to deliver between €43 million and €48 million in 2018.

Our factory rationalization initiative is proceeding in line with expectations with Bjuv scheduled to cease operations by the end of the first half of 2017.

Regarding our third priority, we continue to see further acquisition opportunities and believe we are well positioned to execute both bolt-on synergistic acquisitions in European Frozen as well as broaden strategic transactions globally as a means of delivering value for shareholders.

With that, I will hand over to Paul who's going to cover the financials in more detail.

Paul Kenyon:

Thank you, Stéfan. Before turning back to the presentation, please note that the financial information represents pro forma as adjusted figures for 2015 and as adjusted figures for 2016. All figures have been adjusted for exceptional items, restructuring and transaction-related items and all of my comments from hereon will refer to those as adjusted numbers. To aid users of our financial information, we have included within the presentation an appendix from Slide 15 onwards which will enable you to reconcile non-IFRS financial information to our reported financial information. We will continue to develop the format of these non-IFRS reconciliations as we go forward.

Turning to Slide 5, we thought that it would be helpful to continue to fill in the quarter-on-quarter growth for the Group that we originally published as part of the CAGNY conference presentation. As you can see, with a 3.3% decline, the third quarter shows an improvement in the quarter-on-quarter rates of decline for the fourth successive quarter, starting from the 8% decline in the trough of Q3 2015. As Stéfan noted in his comments, our expectation remains that we will see a further improvement in the rate of decline in the fourth quarter as further Must Win Battles are activated, although there are some offsetting headwinds that will limit the rate of progress in the fourth quarter as I will cover later on. We have also extended the chart to cover 2017 since we will not have completed all of the planned Must Win Battle activations until the end of the first half. We will update our sales guidance for 2017 as our Annual Results presentation, but for those of you starting to think about sales trends beyond the end of 2016, it is worth remembering that 2017 is not a leap year so we have one less trading day in Q1, and that the Easter promotional period falls in Q2 next year whereas it was in Q1 in 2016.

Turning to Slide 6, we show the year-on-year performance for the third quarter of 2016. Revenue was down €32.6 million or 6.9% year-on-year. Adjusting for currency impacts and the exit from Russia, the like-for-like decline was 3.3%, an improvement on the rate of decline in the first half of the year. As has been the case in the past few quarters, the decline in sales was driven by the Group's three largest markets, namely the UK, Italy and to a lesser extent, Germany, although each of these markets again shared reduced rates of decline year-on-year compared to the prior quarter. The Group also saw a drop in sales in France as retailers destocked Iglo products ahead of ordering the new Findus branded SKUs. I will cover this in more detail shortly.

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Gross profit declined by €11.7 million, driven primarily by lower sales volumes. Gross margin declined by 0.5 percentage points, driven by the impact of reduced efficiencies in the factories due to the lower harvest yields.

A&P investment was €1.7 million lower as the Group held back investment over July and August, increasing in September as we upweighted spend for the remainder of the year.

Indirect costs were €14.3 million lower year-on-year due to the releases of the year-to-date accruals related to the Group's annual bonus scheme, synergy realization and the benefits from the Group's Lean Reorganization Program.

Results in Q3 2016 As Adjusted EBITDA was €85.1 million representing 19.4% of revenues.

In Q3, the effective tax rate was 23%, consistent with earlier quarters and with Q3 2015. As adjusted earnings per share increased by 1 euro cent year-on-year due to the increase in as adjusted profit.

Slide 7 contains the comments that I have just made, so I will not repeat them now.

Turning to Slide 8, I will give a little more color on the sales performance. Adjusting for exit markets and the weakening in the sterling rate gives a like-for-like sales comparator of €454.2 million. As I said a moment ago, the majority of the decline is concentrated in the UK, Germany, Italy and France so I will focus my comments on those markets.

The UK business declined 4.6% on a like-for-like basis in the quarter, an improved performance year-on-year compared with the declines in both Q1 and Q2 of this year. The overall UK grocery market remains extremely challenging with the frozen sector in decline. The top four retailers remain highly focused on price to regain the loyalty of value-seeking consumers for whom the hard discount has represented a very real alternative, with both Aldi and Lidl continuing to show strong growth.

The UK business has taken active steps to enter new channels to reduce its reliance on the top four, which now accounts for 67% of the UK business, down from 69% in 2015, and to take a more balanced approach to in-store promotion. The UK team have reset base pricing on the core portfolio to align with retailer strategies and this has been well received by our trade partners. These initiatives have led to short-term value share growth in two of our Must Win Battles: Garden Peas up 190 basis points and Fish Fingers up 280 basis points based on Nielsen 12-week data to the 10th of September. In addition, the UK team has also won new business with one of our top four trade partners in another of our key Must Win Battles, Coated Fish.

In Q4 the UK business will benefit from large Must Win Battle media activations for Fish Fingers, Peas and Inspirations. As I have said before, the UK remains the most difficult market given the structural changes underway in the grocery channel and therefore remains extremely challenging.

In Italy, overall sales continues to decline by 7.4% in Q3 but this is a lower rate of decline when compared to Q1 and Q2 2016. As I've commented before, the economy and consumer confidence remain extremely fragile in Italy, resulting in a decline of 1.9% in the Frozen Food markets in the quarter, whilst private label grew by 1.5% in the same period. We continue to have an ongoing issue with hake fillets, which were impacted earlier in the year by the industry-wide raw material shortage. Although the products impacted by the shortage were relaunched at the end of the quarter, our business has continued to suffer from lower levels of promotions for these products in the short term, although recovery is expected in Q4. In addition, promotional share also declined across the Capitano Fish Fingers and Coated Fish ranges due to raw material price inflation which we have now taken steps to resolve. Excluding the impact of the hake shortage and Capitano product ranges, the Must Win Battles platforms

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are showing encouraging growth rates of 1%, and within that we have seen good development in Peas which were relaunched and are performing at plus 2.2% year-on-year in Q3.

Germany declined by 2.7% year-on-year, a further improvement versus declines of 9.2% in Q1 and 3.9% in Q2. The Must Win Battles identified for Germany are showing encouraging signs with Fish Fingers up 14.1% driven by 360 degree activation which has seen growth in both base and promoted sales on the back of Capitan advertising which will continue into Q4. Our Vegetables business in Germany continues to be impacted by competition from private label where the level of differentiation is lower but we are planning a complete overhaul of the assortment in Q4 where we have plans in place to mitigate this impact.

Having resolved our discount with a key customer we started shipments again in Q3 after a significant change in our way of collaboration and the level of discounts being offered. Inevitably this has resulted in a net sales impact versus last year due to a lower level of promotional intensity. We do have a smaller, more focused range in store with improved profitability.

France declined by 5.7% in Q3 in a market that has declined by 3.1%. As I have mentioned in previous calls, we are in the process of merging our smaller Iglo business in France with our larger Findus brand. As part of that process, we are merging the delisting of the old Iglo portfolio in customers and restocking them with Findus branded replacement products as part of moving to a single trading entity. The delisting process started in Q3, slightly earlier than expected, whilst the ordering of Findus branded replacement products did not start until Q4 and this accounts for the decline in the quarter. Different retailers are moving through this process at different speeds so we expect to see some volatility in the French sales performance over the next three quarters until all retailers are fully stocked with the Findus branded replacement portfolio. This dyssynergy impact is the reason that the overall level of synergy delivery has levelled out in Q3, and as noted above, it will be a headwind to the overall level of synergy delivery until the second half of next year.

Excluding this impact, we continue to see excellent performance in our French Vegetables and Natural Fish sectors which have grown 16.5% and 8.2%, respectively.

The last bar shows the net impact of the remaining countries totaling €0.7 million. This includes growth in Sweden of 0.5% driven by new contracts in our Export and Foodservice channels, and Norway which grew by 3.2% in the quarter, driven by good performance in all channels, especially Retail due to more effective promotional activities on Coated Fish and Fish Gratins. This was partly offset by the Netherlands where aggressive pricing of private label continues, and Austria, where the bankruptcy of a customer at the end of 2015 continues to impact overall volumes.

Turning to the margin performance on Slide 9, we analyze the gross profit movement year-over-year by key driver. Excluding the impact of exit markets and FX rates, our like-for-like gross profit comparator is €133.7 million. Working across the page from this gross profit comparator, volumes were down slightly less than net sales on a like-for-like basis, driving a reduction in gross profit of €0.7 million. The business saw positive mix in the quarter, which impacted gross profit by €0.8 million. This was driven by a shift in product mix in our Norwegian business towards fish products such as Coated Fish and Gratins, and our Swedish business as we focused heavily on our cod product range. As the rollout of our new strategy progresses, we are also seeing declines in those sectors we have identified as non-priority areas for the Group with typically attract lower margins.

Pricing and promotional spend was €8.2 million better year-on-year, driven by the effect of implementing price increases to offset raw material inflation. Performance was also boosted by lower promotional spend, in part due to the Group's net revenue program, but also impacted by specific issues in Sweden as promotional levels have still not fully recovered from the product supply issues experienced earlier this

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year; Germany, as a result of the customer-specific issues, and Italy due to the residual impact of the shortage of hake.

Cost of goods inflation reduced gross profit by €5 million, driven by weakening of the euro against the US dollar, coupled with the impact of lower harvest yields and consequent lower factory recoveries. This was in part offset by lower distribution costs and favorable buying prices across the portfolio.

Moving on to the EBITDA bridge on Slide 10, the like-for-like EBITDA growth was primarily driven by the release of the year-to-date accruals related to the Group's bonus scheme which won't pay out this year, offset by the impact of lower gross profit for the reasons I have just highlighted. On a like-for-life basis A&P spend is slightly lower than last year driven by lower levels of spend in July and August. In contrast A&P spend in September increased 58% year-on-year.

In terms of EBITDA margin performance, the business saw a 2 percentage point improvement year-on-year, driven by the release of the bonus accruals and the delayed phasing of advertising I have just discussed.

Turning to Slide 11, we show the year-on-year performance for the first nine months of 2016. Net revenue was down €88.4 million, or 5.8% year-on-year. Adjusting for currency impact, the exit from Russia, an additional trading day in Q1 2016 due to the leap year, and the business acquisition of La Cocinera in Spain, the like-for-like decline was 4.5%. As has been the case in the past few quarters, the decline in sales was driven by the Group's three largest markets, namely the UK, Italy and Germany, although each of these markets showed a reduced rate of decline year-on-year compared to the second half of 2015.

Gross profit declined by €31 million, driven primarily by lower sales volumes. Gross margin declined by 0.3 percentage points, driven by an adverse mix, the impact of the lower harvest volumes and the dilutive effect of the La Concinera acquisition in Q1, partly offset by pricing year-on-year, lower trade terms investment and a reduction in input costs.

A&P investment was €16.8 million lower, as the Group re-phased advertising spend to align with the anticipated launch of the Must Win Battles to the final four months of the year.

Indirect costs were €18 million lower year-on-year due to synergy realizations, the benefits from the Group's Lean Reorganization program and the year-on-year impact of accruing for the Group's bonus scheme last year. Results year-to-date 2016 As Adjusted EBITDA was €262.8 million representing 18.2% of revenues.

The effective tax rate for the first half of the year was 23%, consistent with year-to-date 2015. As adjusted earnings per share decreased by 1 euro cent in the period driven by the increase in adjusted profit.

Slide 12 contains the comments that I have just made, so I will not repeat them now.

Slide 13 shows the pro forma as adjusted cash flow. The key drivers in the operating cash flow performance, aside from the EBITDA movement, are working capital, which showed an outflow of €28 million, primarily due to the intake of the annual agricultural harvests. This was higher than last year despite the lower harvest levels due to lower creditor balances driven by the advertising phasing change year-on-year. Capital expenditure continued to run at around €6 million per quarter as the Group again maintained tight control of investment levels following the conclusion of the manufacturing footprint review. Two point four million euro of that spend relates to Findus IT integration and hence is non-recurring in nature. As a reminder, capital expenditure levels typically spike up in the fourth quarter due to the Christmas factory shutdowns when major projects are carried out.

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Tax paid was around €8 million, significantly lower than the prior year due to refunds of tax in Germany and Italy of €3 million and €2 million, respectively. We also had lower phasing of payments in the first three quarters of 2016 versus 2015. Our expectation for cash taxes in 2016 remains is now between €20 million and €30 million, equivalent to an effective cash tax rate of 10% to 15%. Restructuring and nonrecurring cash flows of €41 million were largely driven by costs associated with the integration of the Findus Group, the implementation of the Nomad strategy, and the restructuring programs in a number of the Group's factories.

The operating cash flow conversion year-over-year for the first nine months was 81.5%, which was ahead of the prior year. The free cash flow pre-restructuring and non-recurring costs delivery of €160 million is consistent with our €200 million annual targets.

I also mentioned on the second quarter results call that unpredictable weather in 2016 had adversely impacted both our spinach and pea harvests, resulting in lower harvest yields. We're confident that we have enough peas and spinach in stock to minimize the impact of this on our customers but we'll see some excess costs in the region of €10 million hitting our P&L this year of which €6 million have already hit over the last two quarters.

Our net leverage ratio remained at 3.6 times which is 0.4 times lower than the December 2015 ratio of 4 times, driven mainly by an FX translation-driven decrease in gross debt of €23 million and an increase in net cash of €82.7 million.

In terms of our cash guidance of €200 million pre-restructuring and non-recurring, as Stéfan noted in his comments we remain on track to deliver against that commitment. In terms of the restructuring and non-recurring cash slows, as previously highlighted, the re-phasing of the product transfers from the Bjuv site will delay the restructuring cash flows associated with that project into 2017. Having finalized the product transfer program, we now expect to incur costs of around €10 million in 2016 with the balance of the projected €50 million costs being incurred in 2017. So in total, our guidance for restructuring and non-recurring cash flows for 2016 is now around €80 million.

With regard to the rest of our guidance, it remains unchanged from last quarter. We still expect to see a progressive improvement in the rate of sales decline in Q4, although there are some offsetting headwinds that will hold back the rates of progress in the fourth quarter; notably in Sweden where our Natural Fish business has been impacted by delisting following price increases to recover input cost inflation coupled with some product shortages following the poor harvest. Norway is also impacted by pricing on Natural Fish as has been the case so far this year, and the exit of a large, low-margin private label potatoes deal. As noted earlier, trading in France will also be impacted by the transition of the old Iglo portfolio to the Findus brand as we expect further retailers to start the conversion process in Q4.

Lastly, there has been a reasonable amount of press coverage regarding a number of consumer goods manufacturers intentions to raise prices in the UK, ourselves included, following the currency depreciation experienced in the wake of the Brexit vote. We remain in discussions with our customers in the UK and it would therefore be premature to comment on the progress of these negotiations. We will provide a further update in conjunction with our full-year results. We still expect Adjusted EBITDA for the full-year to be broadly flat versus 2015.

I will now hand you back to Stéfan.

Stéfan Descheemaeker:

Thank you, Paul. So in summary, while the commercial market environment has remained challenging in Q#, we believe more than ever that we have the right actions in place to stabilize the business. We are

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starting to see some encouraging early signs from a small number of Must Win Battles that have been fully activated and we expect to continue the progress in improvement that we have now see for four successive quarters since the bottom in Q3 of last year, albeit at a lower rate than we have just reported for Q3 due to the headwinds that Paul has highlighted.

We continue to make steady progress on synergy delivery, and the capability of the business on the cost and cash disciplines remain strong. The Nomad team is totally focused on flawless execution of our strategy, as we move into an intensive period of Must Win Battle activation between now and the end of the second quarter of next year, and I have no doubt that we have the right team in place to deliver on that.

With that, I will turn the session over to Q&A. Operator, back to you.

Operator:

Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, please press star, one if you would like to ask a question.

We'll hear first from Steve Strycula, UBS.

Steven Strycula:

Hi, guys. Can you hear me?

Stéfan Descheemaeker:

Hi, Steve.

Steven Strycula:

Great. The first question—well, actually, I have three quick questions, but the first is going to be on sales. For sales, can you give us, Paul, any kind of cadence help as to how the quarter progressed month by month? You launched a lot of key initiatives in September. Was that the strongest month in the quarter and how should we kind of think about that through—as you go into 4Q? Then also, can you quantify the drag from what's going on in France right now with the transition issues that you're experiencing, and the delisting in Sweden, just so everyone here on the line can understand the duration and the scope of—call it that revenue drag that we're experiencing right now, and then I'll have a margin question afterwards?

Paul Kenyon:

Okay. So, in terms of—I will take France and Sweden first and then I'll come back to the phasing of sales through the quarter. So in France, the portfolio transition explained all of the movements that we showed for the French markets by date, so the €2.3 million in France was all explained by portfolio transition. The business underlying was broadly flat in a declining market.

In terms of Sweden, the salmon shortage will hit across—well, at least some of the delisting is a result of the price activity, will hit across Q4. We have not clarified that or quantified that, to be honest, so we don't put a number to that.

In terms of the sales profile through the quarter, September was not a bad month, so we did see a bit of a lift in September. As I was saying in the Q2 results, July and August are always slightly strange months

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for us in terms of—obviously, the cabinets, particularly in Southern Europe, are focused on ice cream, and we can be quite weather-dependent, so if there's a real heat wave in Europe, we can see lower sales as people eat lighter food and tend to dine outside and therefore not use the ovens, and a lot of our products are oven-prepared. So, July and August can always be a bit bouncy for us, but September was a solid performance for us year-on-year.

Stéfan Descheemaeker:

I would even add, you know, September—to give a bit more color, for example, the UK was—we're starting to see real progress, again, with the activation of Must Win Battles.

Steven Strycula:

Can you provide any kind of anecdote as to how the UK environment is improving? Specifically, as you mentioned in September, are these new monies that you're putting back into the business, whether it's product enhancement, advertising, all these initiatives in the marketplace, is it moving the needle with your retailers—give us any kind of anecdotal example or Nielsen numbers? Then, how do you think about the pricing as we go forward, because your peers in private label also have to take up pricing, but how do you balance that out once you see about like what happened in Sweden in the past quarter?

Stéfan Descheemaeker:

So, let me start with some anecdotal. These actions that we're taking in the UK from September and onward, and definitely in October, and so what we're doing right now—actually, we have three advertising on air. One is the Captain. Actually, what we did with the Captain was we re-adapted the German copy, and I can tell you it delivers really well, so that's pretty good. That's very inexpensive and you can see that in very lasting results, which, by the way, says something about the value of the icon in the UK. We hadn't seen the Captain for 10 years and it's back on track. Everybody remembers the Captain and it delivers.

Second, we also said that we need to do something with our Peas, which was losing some sort of relevance vis-à-vis the private label, because we had not invested in the past behind Peas. So, again, we have a new copy on air and, again, very, very early results, delivers really well.

Third, something which was also going down, is we have a new copy for our Inspirations range. Again, too early to say, but at least what we've seen is interesting.

This again, back to what Paul said about the 360 activation, we're coming with a 360 activation for these ranges, so it's coming with obviously price promotion and also new packaging. We said previously that packaging needs to be readapted and we've been that way. Readapted means, you know, again, the brand on the side, back to high-quality pictures. The food is obviously the center of the whole thing. Again, we invite you, once you're back in the UK to see the freezers, and it's really a major difference.

So, what we see—these are some anecdotes but at least, really, you know, strategy in action and we are very pleased with the results so far.

Back to the question of price, it's obviously a very volatile environment right now in the UK. To your point, Steve, everybody is hit obviously by devaluation; even moreso the private label producers, because obviously they're starting from a much lower margin. So, the key question is obviously who is going to do something first. So, it's not so much the when—the if, it's much more the when. We've started the process, so that's why Paul mentioned it's volatile right now. It's difficult to predict. We are in the middle of this negotiation so that's why we prefer to be cautious.

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Paul Kenyon:

Just to give you some color on the UK from the Nielsen data, Steve, we have seen a lower share loss in the four weeks and the last 12 weeks, and a lower share loss in the last 12 weeks in the MAT, or moving annual total, and on volume share, we've actually seen volume share growth in the last four weeks and 12 weeks, and a small loss on an MAT basis. So, the lead indicators are that what we're doing in the UK is working. We always knew in the UK it would be volume first, then value. We're working hard on the value, as you know, from the pricing actions we're taking, but we are starting to see some encouraging signs in the UK.

Steven Strycula:

Great, and then I have one last question and I'll pass it along. So then how should investors think about necessarily the next point or inflection where the sales trend should really start to improve in the business? Obviously, you have a little bit of ongoing headwinds continuing in the fourth quarter, but should we expect some kind of continued step-function higher in the first half of next year? Then related to EBITDA, Paul, you did comment that the €330 million is still a reasonable forecast for this current year. How should we think about the building blocks for next year? Not necessarily guidance but you had a poor pea harvest this year, the bonus accrual situation, as well. What should be the larger building blocks as we think about margins for next year? Thanks.

Stéfan Descheemaeker:

Okay, let me start with sales. As Paul told you, we're not going to come at this stage with guidance for 2017, as we're going to take obviously—we're going to mention that at the appropriate time, which is later next year, but at the same time nothing has really changed. As we said, you know, we have still a series of Must Win Battles that need obviously to be activated the 360 way. We said that it's probably—the full activation of all the Must Win Battles which together represent 75% to 80% of our business, is going to be in full motion by the end of Q2 which means that, yes, we have no reasons to believe that the strategy is wrong and that we're very confident that we're going to keep it that way.

Paul Kenyon:

In terms of building blocks for next year on EBITDA, obviously you have on the positive side synergies coming through. We also obviously are expecting to see a lower rate of decline in sales as we head through the year, so we will have a stronger commercial base. As we evolve the portfolio through the Must Win Battle activations, we will see tail portfolio disappear so as we progress through the year, incrementally, small step by small step, we should see more of our product range manufactured in our own plants because our Must Win Battles tend to be manufactured in our own plants so we capture the efficiencies of that. So, we do have some positive tailwinds that we're generating through our own cost management programs. Offsetting that, obviously, are the inflationary headwinds. We are seeing some input cost inflation in some categories, or at least that's the forecast as we see it at the moment, and we will certainly have some effects-based inflation as a result of the movements of sterling and the euro and the Swedish krona, the Norwegian krona against the dollar, particularly, in regard to our fish purchases. The poorer harvests also require you to price, because obviously the price per kilo of harvest has risen.

So, all of that means we are having to price in an environment that is challenging to price in—not impossible, but challenging, so we have that to absorb, and then obviously we will be looking to reinstate some bonus scheme in the business, although that would obviously only pay out if we achieve our targets. So, yes, there will potentially be a headwind from reinstating the bonus scheme but only if we achieve our targets.

Stéfan Descheemaeker:

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In the meantime, obviously, we will keep the business on a very tight leash, more than ever, in terms of indirect, that's a fact, and our network new management program is also starting to expand across the organization. That's going to obviously help to finance these rebuilds between Must Win Battles, bonus, and also to some extent also some additional quality investments that we're making.

Operator:

Thank you. We'll hear next from Jon Tanwanteng, CJS Securities.

Jonathan Tanwanteng:

Good morning, gentlemen, and thank you for taking my questions.

Stéfan Descheemaeker:

Hi, Jon.

Paul Kenyon:

Hi, Jon.

Jonathan Tanwanteng:

Hi. Can you give us a little more detail about how you're managing through the existing currency climate? I know you don't want to talk about pricing just yet, but what further steps have you taken on the supply chain and the manufacturing side, if any?

Paul Kenyon:

So, as we said last quarter, we have hedging in place through to the end of the year and our hedges continue to roll forward. So as we sit here today, we're probably about 40% to 50% hedged for 2017, and that will continue to build as we move through the balance of this year and into next year.

In terms of how we look at managing that cost—and clearly we endeavor to pass on inflationary trends to customers and consumers, and we have a reasonable track record of doing that. So although as I said just now, it's a fairly challenging environment to pass on right price rises, but we are, as you will have seen from the press coverage, engaged with the retail trade, particularly in the UK which has seen the sharpest depreciation in currency, so we are actively pursuing that. We obviously also have net revenue programs aimed at optimizing our promotional spend, which is a big line for us. We have a very experienced supply chain team who are very focused on efficient cost to manufacture, and we continue to run programs to take costs out of our supply chain base, as well. Lastly, we have the lean program on the indirects.

We also continue to work very hard on our advertising line to make sure that we squeeze the maximum number of gross rating points out of our euro—millions of euros of investment. As you know, we changed our media buying agency again this year, to Zenith, and we have reaped additional benefits, which has allowed us to get more GRPs per euro on the working media spend, and we obviously challenge everything we can on non-working to maximize the amount of working media we have.

Every line of the P&L is subject to challenge and that goes for the cash flow statement, as well. We work very hard to maximize the cash delivery from the business as well, as I think you can see from our cash statement for Q3.

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Jonathan Tanwanteng:

Okay, great. Mentioning the marketing, you've pushed out A&P spending for a couple of quarters now. I know you started to ramp that in September. How much advertising spend should we expect to see in Q4 and how does that compare to Q4 of 2015? Maybe just to follow on, will that increased rate continue into 2017 as well?

Paul Kenyon:

We think we have about the right number of euros. As I've just said, we aim to squeeze more gross rating points out of that number of euros than we have in the past. In terms of the phasing this year, it is going to be back-end weighted because we decided to hold off until we had the 360 degree activation launches ready to go in September. As I commented in the script, September's A&P was up 58% year-on-year, so that gives you some idea of the weight of advertising we're putting into Q4, and that we expect to continue not necessarily at 58% increases but we expect to see significant increases through the end of the year, and our expectation is that the total spend for the year will be broadly the same as 2015. We might not quite get to the 2015 number, because obviously we have a fairly short amount of time left to spend the money, but that's our ambition.

Going forward into 2017, a bit early to be giving guidance, but I mean I think we will—we have the right amount of money to spend behind the Must Win Battles. We will obviously, because we'll be launching them through the first half of the year, even out phasing, so I think you'll see back-end-loaded phasing this year. I think we'll see more even phasing next year, but we don't necessarily feel we need more money next year at this point. Clearly, if we see a significant response to our advertising and there's a good case to be made for investing more we will always look at that, but right now I think we're comfortable with the current level of advertising.

Stéfan Descheemaeker:

So, what you really to remember is it's not, you know, savings, it's phasing, more than anything else, that's very important. We said that from the start for this year. It makes a lot of sense. Second, it's going to be even more focused next year behind the Must Win Battles, if possible. Third, we still are going to work further on the efficiency between working money and non-working money, and we still believe that we have some way to go, which is good news.

Jonathan Tanwanteng:

Great, that's helpful. Paul, can you just break out how much impact the reversal of the bonus accruals had in the quarter?

Paul Kenyon:

Yes, in the quarter, we had about €7 million of releases. So, in the quarterly statements of that, I think it was …

Stéfan Descheemaeker:

I think it was 7.6.

Paul Kenyon:

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Yes, of the 14, about 7 is releases. Year to date—obviously because you accrue at different rates in the two different years—year to date about 3 million. So, we had full accruals through to the end of the first half of 2016, which we released in Q3 2016. In 2015, we fell out of bonus achievement earlier, so we had a relatively—we actually didn't have a release in Q3 last year but we were still carrying accruals from the first half of about 3 million. So, the difference in year-to-date terms is about 3, in the quarter about 7.

Jonathan Tanwanteng:

Got you, thank you. Then finally, Stéfan, I'm not exactly asking for 2017 guidance, but do you think we might see year-over-year revenue growth sometime in 2017, once you activate all of your Must Win Battles, at least by the end of Q2?

Stéfan Descheemaeker:

Thank you, Jon, for not asking for guidance because it really looks like guidance, quite frankly, so I'm not going to come to that debate at this stage. We will come in due time with the right level of guidance. The only thing you need to remember is we're pleased with the results we have achieved so far with the Must Win Battles. When you think, you know, back again, something like 12 months ago, we knew we had the right strategy, but we had—quite frankly, we didn't know exactly how fast the Must Win Battles would activate, and the whole efficiency and what we've seen so far is we have been everything but disappointed.

Jonathan Tanwanteng:

Great. Thank you very much. I appreciate the commentary.

Operator:

Thank you. Next, we'll hear from Brian Holland, Consumer Edge Research.

Brian Holland:

Thanks. Just some housekeeping here at the start. What did A&P spend look like relative to your expectation prior to the quarter? Did you make a decision intra-quarter to change the way that you spent A&P this quarter, and if that's the case, just any color around how you thought about that?

Paul Kenyon:

Not really. I guess as we looked back at the spend levels, we did in a couple of markets trial advertising over the summer period last year, so we trialed advertising in Italy, for example, which we don't normally do, because obviously your base sales are lower and you tend to try and advertise against higher base sales periods because you get a bigger uplift, but last year we had some advertising running through July and August. This year we pretty much pulled back to barely maintenance levels to preserve buying power in September, which is why you see such a big hike in September. So, year-on-year, the phasing was different, but that wasn't out of line with our expectations as we headed into the quarter.

Brian Holland:

Great. Thank you.

Stéfan Descheemaeker:

The 360 activation is the real (inaudible).

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Brian Holland:

Sure. So to clarify, on synergy delivery you're expecting that the levels seen in Q3 to sort of persist through the first half of next year, and then how do we think about the cadence from there? Should synergies start to move higher again sequentially in the back half of '17?

Paul Kenyon:

Yes, I mean, as the French portfolio finishes its transition, you'll have that brake taken off. You'll also start to see benefits from the closure of the Bjuv site come through in the second half of next year, and as we progressively roll through contract renegotiation you'll see some procurement benefits coming through, as well.

Stéfan Descheemaeker:

To Paul's point, we're not changing our guidance in terms of the synergies, which is €43 million to €48 million by the end of 2018, so, yes, definitely, it will accelerate.

Brian Holland:

Thank you. Most of my questions have been answered, so just in closing, could you refresh for us how you're approaching M&A? I guess thinking about your balance sheet, ongoing strategic initiatives and integration on your core portfolio, do you feel you're in a position to do a deal today? Second, what are kind of—if you could sort of reset for us what the ideal parameters you're targeting with respect to size, temperature class, geography, valuation, et cetera?

Paul Kenyon:

Sure, Brian. The answer is we're very well positioned to do deals today. We have a reasonably significant amount of cash on the balance sheet, due to the inherent cash-generative nature of the business, and we continue to scan the horizon for deals. I think my ideal deal would be a business that came with probably no factories, that we could drop the volumes into our own factories and get significant scale economies from, whilst being able to sell and market it without taking on a single extra person. There aren't many of those businesses around, to be honest, but I think we …

Stéfan Descheemaeker:

The same sort of category.

Paul Kenyon:

So, we remain focused on highly synergistic deals. So that would be, ideally, deals in Fish, Vegetables, Poultry, Home Meals in either our current geographies or adjacent geographies where we have gaps in our portfolio. The Barclays Conference had that slide with the kind of 13 markets, four key categories, 52 potential leadership positions of which we have leadership in 35 I think it was. So, coloring that chart Nomad blue remains our ambition. We'd also look at adjacent geographies. So if there are good quality markets that we're not currently present in where we get the opportunity to buy a market-leading position, we would certainly look at that, as well. Again, if it comes with or without a factory, it just changes the level of synergies and the level of one-time costs you invest as part of the deal.

Stéfan Descheemaeker:

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Then, on the other extreme, you have obviously a factory doing private label only, which was obviously something they lack, you know. The other extremes are the things we don't want. Then, you have a lot of situations in-between. Obviously, the closer we get to what the ideal picture described by Paul, the better we are.

Brian Holland:

Just as a follow-on then, or to clarify, looking for top one, two or three market positions in the respective categories, is that an important parameter?

Paul Kenyon:

Yes, we believe that there is a strong correlation between return and market position. We're obviously number one in European Frozen by a factor of 2.8 times and our margins, I think, reflect that kind of position. Within the markets we operate in, we do tend to see a difference in margin between player number one and where we're number two or number three, so we do believe that there is value for our investors in establishing, ideally, strong number one positions in each category in each market. Failing that, a decent number two position can still create a lot of value for our shareholders, particularly if it's part of the business that is number one overall in the market. It's a simple question of scale with customers. So, you know, if you're number one in our four key categories, it's very easy to position yourself as a category captain with retailers, and if we build in Fish, Vegetable, Poultry and Meals, it allows us to extract scale economies which again benefit our investors.

Stéfan Descheemaeker:

Yes, the correlation between margin and market share is obviously a very important one, and from that, you know, you can immediately see the kind of obvious synergies between a mid-sized player in one category or footprint.

Brian Holland:

Thanks, gentlemen. I appreciate the color. Best of luck.

Stéfan Descheemaeker:

Thank you.

Operator:

Thank you. There are no further questions at this time. I'd like to turn the call back to Mr. Stéfan Descheemaeker for any additional or closing remarks.

Stéfan Descheemaeker:

Very good pronunciation, by the way. Fantastic, thank you. Let me finish by thanking you all for attending the call today. While I take encouragement from the progress made on implementing our strategy so far, there is still much to do and we remain focused on our key objectives for the year: firstly, to stabilize the top line; secondly, to deliver the predicted synergies; and thirdly, pursuing a highly synergistic deal in European Frozen, as well as broader strategic transactions globally, as a means of delivering value for our shareholders.

With that, I wish you a good day and hand back to the Operator.

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Operator:

Thank you. That does conclude today's presentation. Thank you for your participation. You may now disconnect.

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